Fair Political Practices Commission
MEMORANDUM

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin and Remy

From: Lawrence T. Woodlock, Senior Commission Counsel
Luisa Menchaca, General Counsel

Subject: Update on Proposed Regulations 18530.3 (Mixed Federal and State Expenditures by Political Party Committees) and 18534 (Hard and Soft Money Accounts).

Date: June 22, 2006

Executive Summary

This memorandum will update the Commission on the status of two proposed regulations originally explored in 2005. First, staff introduced regulation 18530.3 last May to codify certain rules on the application of contribution limits under the Political Reform Act ("the Act"),[1] along with the allocation of contributions and expenditures, and the reporting of campaign receipts and expenditures. This regulation would apply to state and local political party committees, and was designed to clarify the interaction between state and federal laws that govern these committees.

The political parties joined in objecting principally to two provisions in this regulation – a requirement that state rules be used to measure the value of expenditures in state and local campaigns when the federal provisions yielded inaccurate results, and a requirement that certain contributions from federal to state committees be attributed to specific donors to the federal committee, enabling the state to monitor compliance with its own contribution limits.

The parties argued in the alternative that state rules would be preempted whenever they varied from the corresponding federal rules governing political party committees, and persuaded the Commission to suspend further rulemaking until it could obtain an Advisory Opinion from the Federal Elections Commission on the proposed regulation. The FEC declined to issue an Advisory Opinion on a regulation that had not yet been adopted by the Commission, and the regulation thus returns to the Commission with the principal points of contention unresolved.

In December, while the Commission deliberated on a request for guidance from the FEC, it also took up proposed regulation 18534, which would provide rules for segregating "hard" and "soft" money contributions to political committees, a necessary step in defense of the committee contribution limits of section 85303. Here, there was widespread support for passage of such a rule, and debate was reserved for certain details of implementation. Staff attrition forced a delay in working out these details, and because many of the parties interested in regulation 18530.3 would also be interested in regulation 18534, an Interested Persons' Meeting on both topics was conducted on June 20 to provide outside input as staff prepared to advise the Commission on its

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[1] Government Code sections 81000 – 91014. Commission regulations appear at title 2, sections 18109-18997, of the California Code of Regulations.

progress. Staff now recommends that both of these matters be placed on the Commission's September calendar for a second prenotice discussion, to incorporate lessons learned over the past several months, and comments from the regulated community.

Discussion

1. *Regulation 18530.3 – Combined Federal/State Expenditures by Political Party Committees*

To ensure that money exempt from federal regulation is not used to influence federal elections, the Federal Election Campaign Act requires that some fraction of any expenditure made to influence both federal and state elections be made from money raised under federal rules or, in the case of "Levin funds," under a combination of federal and state rules.[2]

The regulated community recognizes that mixed federal and state expenditures by political party committees must be allocated between state and federal uses and reported, *in some fashion*, under both federal and state law. California has a particular interest in ensuring that its contribution limits remain enforceable when a combination of state and federal money is used in a California election campaign.

Federal allocation formulas sometimes require over-estimation of amounts spent to influence federal elections. This suits the federal goal of filtering out money not raised under federal rules. But the federal preference for such formulas does not go so far as to mandate that California integrate them into its own reporting scheme, when other allocation methods already in common use more accurately describe how the money was actually spent in state contests.

The original draft regulation (copy attached) was simple in outline. Subdivision (a) said that all contributions to political party committees, and all payments by such committees, are reportable under state rules if not governed exclusively by federal law. The contribution limit at section 85303(b) expressly applies to contributions described in this subdivision, if they will be used for the purpose of making contributions to candidates for elective state office.

Subdivision (b) treats cases where federal law requires or permits a campaign expenditure presumptively benefiting both federal and non-federal candidates to be paid from federal money, some portion of which may later be reimbursed by the party's non-federal account. The proposed regulation provides that such reimbursements, if they do not equal the full value of benefits to a non-federal account, shall be deemed to be transfers of contributions from federal to non-federal accounts. If federal allocation formulas do not accurately measure the benefit of non-federal expenditures on state or local campaigns, they may *not* be used for state reporting purposes.

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[2] A more detailed discussion of state and federal law, and the pertinent legislative background, is contained in staff's memorandum for the May 2005 meeting, which will be recapitulated and updated in the prenotice memorandum, when the Commission's attention will be inevitably be drawn to the "fine print" that is mercifully unnecessary in an update memorandum.

Subdivision (c) specifies that transfers by a party committee under subdivision (b) must be allocated to individual federal contributors, but will not result in violation of state contribution limits if the donor had not earmarked the contribution for use in state or local campaigns.

Finally, subdivision (d) provides that party expenditures on overhead, voter registration, or generic party-building activities may be apportioned by any reasonable accounting method as between expenditures attributable to federal and to state or local party activities. Thus the party may, if it chooses, employ federal allocation formulas for such expenditures. The state's interest in accuracy over approximation is most urgent in accounting for expenditures made to influence the outcome in election contests, and may be relaxed in areas of party overhead and maintenance.

Staff anticipates that some members of the regulated community will again object to any regulation that continues to impose longstanding state allocation rules for state reporting, now that the federal rules have evolved into minimum allocation formulas that may or may not reflect the underlying reality of mixed federal/state expenditures. The proposed regulation does so only when federal rules are inaccurate, but the parties have argued in the past that it is difficult for treasurers to continue using state rules for state reports when federal approximations are simpler. A more sophisticated and possibly stronger variation of this argument surfaced at the recent Interested Persons' Meeting, which acknowledges that the problem lies not in a lack of expertise among committees and treasurers, but in the press and the public, who may be confused when they find different figures reported in parallel state and federal forms.

A second major point of contention will be the previously-aired opposition to allocations back to individual contributors, when contributions transferred by a federal committee to a non-federal committee result in a subsidy by the federal committee of expenditures made to influence a state election campaign. The stakes here are the same as before. It is more convenient for the committees to pencil in the total amount of the contribution without allocation back to original contributors, while such a practice would make it impossible for the state to monitor compliance among these donors with state contribution limits.[3]

The spectre of federal preemption may still be raised to supplement objections to the substance of regulation 18530.3. Staff did not credit such arguments last year, and believes that they are still less credible today, particularly after a recent FEC Advisory Opinion to the Los Angeles County Democratic Party Central Committee, where the FEC made it clear that it did not intend by its rules to "federalize" state and local political campaigns.[4] In any event, since the FEC has declined to issue an Advisory Opinion on preemption while regulation 18530.3 remains a merely hypothetical possibility, it is necessary to move forward with adoption of regulation

[3] On June 9, 2006, Charles Bell presented an alternative draft of regulation 18530.3. Mr. Bell's trial schedule prevented his attendance at the Interested Persons' Meeting, but Staff hopes to discuss this proposal with him soon.
[4] See *Zakson* Advisory Opinion, No. 2006-19. A recording of the May 25, 2006 meeting at which the six-member Commission discussed this matter may be found at: http://www.fec.gov/agenda/2006/agenda20060525.shtml

18530.3, if only to provide the basis for a dispositive statement on the question.

This regulation can be brought back for prenotice discussion in September, and set for adoption after the November election, with its effective date stayed, if necessary, while staff obtains an Advisory Opinion from the FEC.

2. *Regulation 18534 – Segregating "Hard" and "Soft" Money*

Proposed regulation 18534 (copy attached) was drafted after an investigation into events surrounding the 2002 statewide election, which brought to light violations of section 85303 by county central committees. Regulation 18534 would require party committees to keep separate bank accounts for deposit of contributions to be used in supporting or opposing candidates for elective state office, as distinct from contributions intended for other purposes. The regulation also contained rules to ensure that funds deposited into a "non-candidate support account" could not be re-designated to candidate support by transfer to other committees. The Commission opted to bring this matter back for a second look and recommended a second Interested Persons Meeting, which was held on June 20, 2006.

At the December Commission meeting, there was no disagreement on the utility of such a regulation, and there was general agreement on the draft, with three significant details still to be worked out. *First*, whether a committee that anticipates receipt of over-limit contributions must open two bank accounts, or might lawfully employ some accounting method to segregate and track the funds within a single bank account.

It does not appear that the maintenance of a second bank account would be a substantial burden even on small committees. If there were any appreciable burden, it could be reduced or eliminated by attention to the name and purpose of the "default" account, the *second* question remaining after the December meeting. If the regulation were drafted to provide that every committee be required to have a statewide candidate support account, small committees that did not anticipate receiving over-limit contributions could accept all contributions into that account, and use it to make all expenditures. Committees like these would not require a second account. When the optional account is a "non-candidate support account," it would be needed only if a committee anticipates or receives over-limit contributions.

The consensus at the December meeting seems to have been that the account "names" employed above may be confusing, should be altered in the next draft, and should be used by all committees to eliminate ambiguities in the permissible use of funds coming from those accounts.

The *third* undecided question is whether the regulation should permit a committee with two accounts either to deposit an over-limit contribution into the default account, with a transfer of the required sum to the secondary account within 14 (or 30) days, or to "split" the contribution at the time of deposit, with the appropriate sums going to each account on the date of deposit.

These remaining problems will be addressed at the prenotice meeting in September.